

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 98-0493 ST
SALES AND USE TAX

For Tax Periods: 1994 Through 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

Issues

1. Sales and Use Tax- Dust Lights

Authority: IC 6-2.5-3-2 (a), IC 6-8.1-5-1 (b), IC 6-2.5-5-4, 45 IAC 2.2-5-10 (c), *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983).

The taxpayer protests the assessment of tax on dust lights.

2. Sales and Use Tax-Computer Software

Authority: IC 6-2.5-3-2 (a), Sales Tax Information Bulletin #8, *Lincoln National Life Insurance Company v. Indiana Department of State Revenue*, Ind. Cir. Ct., Noble County Docket No. C-80-635 (October 20, 1981).

The taxpayer protests the assessment of tax on computer software.

3. Sales and Use Tax-Labels and Label Printing Machine

Authority: IC 6-2.5-5-6, IC 6-2.5-5-3, 45 IAC 2.2-5-14 (e).

The taxpayer protests the assessment of tax on labels and the label printing machine.

4. Tax Administration-Negligence Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the assessment of the negligence penalty.

Statement of Facts

The taxpayer is a manufacturer of kitchen and bath cabinets that are sold mostly at wholesale to retailers. After an audit, the Indiana Department of Revenue, hereinafter the “department,” assessed additional sales and use tax, interest, and penalty. The taxpayer protested a portion of the assessment and a hearing was held. Further facts will be provided as necessary.

1. Sales and Use Tax-Dust Lights

Discussion

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

IC 6-2.5-5-4 provides an exemption from the use tax for tangible personal property directly used in the direct production of the taxpayer’s product. In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production.

The taxpayer has sanding booths for the individual sanders’ use. These booths originally had no attached lighting. After a period of time, the taxpayer decided to attach lights with dust protection to each of the booths. The dust lights were specifically engineered and constructed for this purpose. The lights supplement the general lighting in the room. The department assessed use tax on the dust lights. The taxpayer argued that these lights qualify for the manufacturing exemption.

Because the taxpayer’s employees were able to produce the cabinets without the dust lights prior to their installation, the dust lights cannot be essential and integral to the production process as required for the manufacturing exemption. Further the dust lights do not directly impact the production process as required in the regulation. Although the dust lights improved the working situation, they do not qualify for the directly used in direct production exemption from the use tax.

Finding

The taxpayer’s first protest is denied.

2. Sales and Use Tax-Computer Software

Discussion

The department also assessed use tax on the taxpayer’s use of a computer software licensing agreement pursuant to IC 6-2.5-3-2 (a). The taxpayer contends that since the computer software licensing agreement was intangible rather than tangible personal property, it was not subject to the use tax. The taxpayer bases this contention on the finding in *Lincoln National Life Insurance Company v. Indiana Department of State Revenue*, Ind. Cir. Ct., Noble County Docket No. C-80-

635 (October 20, 1981). In that case, the Noble County Circuit Court held that a computer program software license was intangible, intellectual personal property and not subject to the Indiana sales or use taxes.

The taxpayer's reliance on *Lincoln National* is misplaced. *Lincoln National* is a nonappellate opinion. It was decided in a county circuit court prior to the creation of the Indiana Tax Court. As such, it does not serve as general precedent.

The department's interpretation of the sales and use taxability of canned or pre-written computer programs has been consistently available for taxpayers in Sales Tax Information Bulletin #8 that states as follows:

Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is not different than the intellectual property in videotape or a textbook.

As tangible personal property like a textbook, the use of pre-written or canned software is subject to the use tax.

Finding

The taxpayer's protest is denied.

3. Sales and Use Tax-Labels and Label Printing Machine

Discussion

The taxpayer also protests the assessment of use tax on certain carton labels. Pursuant to IC 6-2.5-5-6, transactions involving tangible personal property are exempt from the use tax if the purchaser acquires it for "incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business."

This exemption is further explained at 45 IAC 2.2-5-14 (e) as follows:

. . . incorporated as a material or an integral part into tangible personal property for sale means:

- (1) The material must be incorporated into and become a component of the finished product.
- (2) The material must constitute a material or integral part of the finished product.
- (3) The tangible property must be produced for sale by the purchaser.

The taxpayer attaches the subject adhesive labels to its shipping cartons. These labels identify the size, type, and style of the product. Two of the taxpayer's major customers submitted letters indicating that they require the information provided on the labels. Therefore, the taxpayer argues that the labels meet the statutory and regulatory requirements for exemption.

The cartons to which the taxpayer affixes the labels are cardboard shipping cartons designed to protect the taxpayer's product during shipping. Shipping cartons are not an essential part of the final product. Therefore, the labels that are attached to the shipping cartons do not become part of the finished product and do not qualify for exemption.

The taxpayer also protests the assessment of use tax on the machine used to print the labels. The taxpayer contended that the machine qualified for exemption because it was directly used in the direct production of tangible personal property produced for resale pursuant to IC 6-2.5-5-3. Since the labels are attached to the shipping carton, they are not part of the finished product produced for resale. The label printing machine operates on labels which are not part of the finished product. Therefore, it does not impact the final product and it does not qualify for exemption.

Finding

The taxpayer's protest to the assessment on the labels and the label printing machine is denied.

4. Tax Administration-Negligence Penalty

Discussion

The taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence.

The taxpayer failed to follow the law, regulations, and generally available departmental instructions by failing to pay sales or use tax on several varieties of clearly taxable items such as office supplies, first aid supplies, cleaning supplies, and general maintenance supplies. Some of these same items had been assessed in a previous audit. This constitutes negligence. The negligence penalty was properly applied.

Finding

The taxpayer's protest is denied.